DIRECTORS AND PUBLIC ISSUES

By P. C. HEEREY*

INTRODUCTION

The statutory regulation of issues of company securities to the public in Australia accords with the disclosure philosophy which is basic to most of our company legislation. The machinery adopted relies in the main on the prospectus, which can be briefly described as a document containing a large amount of prescribed information about the company and the proposed issue.

The prospectus is registered with the Registrar of Companies and before being so registered must comply with the Act.[1] That means that on its face it must contain all the information which the Act requires. The accuracy or otherwise of this information is no concern of the Registrar; the sanction is provided by the civil and criminal liabilities which the Act imposes for misstatement or omission.[2]

The assumption underlying this approach is that an investing member of the public, given certain information, can make an intelligent decision. At this stage legislatures appear to assume that the duty of the state does not extend either to actively investigating the truth of this information or to making any qualitative assessment of it.

In the half-decade since 1960 this assumption has been seriously questioned on a number of grounds including: 1. The fact that a large number of investors in fact do not form and are not capable of forming competent judgments, but rely on the professional or quasi-professional advice of stockbrokers, bank managers, financial journalists, etc. who themselves have not always been as astute as they might have been. Moreover, one suspects in some instances, these advisers themselves are relying on the advice of others and have not made a first-hand examination of the prospectus. 2. The enormous practical difficulties in the stable-door-shutting-operation of recovering the loss of investors after the collapse of a company.

Doubtless the introduction of an alternative system along the lines of the U.S. Securities and Exchange Commission[3] would require enormous expansion in governmental regulation of companies but

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[1] S. 42 of the Companies Act 1962 (Tas.); the Companies Act 1961 (Vic.); the Companies Act 1961 (N.S.W.); the Companies Act of 1961 (Qld.); the Companies Act 1961 (S.A.); the Companies Act 1961 (W.A.); The Companies Ordinance 1961 (A.C.T.), all of which are hereinafter referred to as the Uniform Companies Act.

[2] It is to be noted, however, that legislation has been introduced in New South Wales and Victoria Act No. 7391 (Vic.) s. 11 giving to the Registrar power to reject a prospectus on the ground that it contains matter which in his opinion is misleading, Law Council of Australia Newsletter, Vol. 2, no. 1 (April 1966).

[3] See the article of Professor H. A. J. Ford in this issue.

the argument still remains that if our economic system is to be based upon investment funds raised from the general public, then the legal machinery by which the system operates should provide more protection for the public. The partnership of investor and entrepreneur, like any worthwhile partnership, cannot operate jointly and effectively if one party is in an inferior and unprotected position. This principle is recognized in other fields such as hire-purchase and the sale of goods where statutory consumer protection is given to compensate for the economically superior bargaining position of vendors. Moreover, while the amount of money lost by individual investors in public companies in Australia might be small when compared with the total amount invested, in human terms its significance is very great. Both the personal hardship suffered by investors, and the loss of public confidence in the present investment system are factors which must not be overlooked in any re-appraisal. However, the object of the present paper is to examine some aspects of the operation of the existing legislation. The significance for directors, of course, finds its roots in: 1. Section 46(1) of the Uniform Companies Act which creates a civil liability (subject to certain defences) for misstatements and non-disclosure in a prospectus on a person who was a director at the time of issue of the prospectus. 2. Section 39(4) which make a director of a company which issues a prospectus not in compliance with the Act liable to a penalty of $2,000.

The following examination will be confined to the provisions of the Companies Act and no attempt will be made to deal with the common law and equitable liability of directors for deceit misrepresentation and negligence (the relevance of *Hedley Byrne & Co. Ltd. v. Heller & Partners Ltd.*[4] to Company Directors appears to be a fruitful field which remains to be investigated).

SCHEME OF THE ACT

The provisions of the Uniform Companies Act can be conveniently categorized by reference to whether shares are issued or unissued at the time of their offer to the public. In all cases a vital element is whether or not there is an offer to the public.

1. *Unissued Shares*

(a) If shares or debentures are offered to the public, no form of application may be issued circulated or distributed unless accompanied by a prospectus, a copy of which has been registered by the Registrar.[5]

(b) Any advertisement or notice referring to the issue must be restricted to the matters mentioned in section 40. Section 40(1) provides that the advertisement must state that applications for

[4] [1964] A.C. 465. [5] S. 37 (1), (2).

shares or debentures will proceed only on one of the form of application referred to in and attached to a printed copy of the prospectus.

(c) The stratagem of the company allotting shares or debentures to a person with a view to that person offering them to the public is met by section 43 which provides that the documents by which the shares are offered to the public is to be deemed a prospectus.

The combined result of these provisions is that whenever an offer of shares or debentures which are to be issued by a company is made to the public a prospectus which complies with the Act must also be issued.

2. *Issued Shares*

(a) Where the shares or debentures are quoted on a stock exchange they may be offered for sale to *a member* of the public (as distinct from the public in general) without formality.

(b) If such an offer is made by advertisement then section 40 applies, and a prospectus must be available. This is because section 40(1) refers to 'an offer . . . of shares . . . to the public for subscription *or purchase*'.

(c) If the shares or debentures are not quoted on a stock exchange then section 374 (3) applies and a document as prescribed must accompany the offer. This document must contain certain specified information about the company—although not as much as a prospectus —and is not required to be registered with the Registrar.

THE STATUTORY CAUSE OF ACTION UNDER SECTION 46

Section 46(1) provides as follows:

> 46(1) Subject to this section, each of the following persons shall be liable to pay compensation to all persons who subscribe for or purchase any shares or debentures on the faith of a prospectus for any loss or damage sustained by reason of any untrue statement therein, or by reason of the wilful non-disclosure therein of any matter of which he had knowledge and which he knew to be material, that is to say every person who—
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> (a) is a director of the corporotion at the time of the issue of the prospectus;
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> (b) authorised or caused himself to be named, and is named, in the prospectus as a director or as having agreed to become a director either immediately or after an interval of time;
>
> (c) is a promoter of the corporation; or
>
> (d) authorised or caused the issue of the prospectus.

It is proposed to deal selectively with some of the problems raised by this section.

1. RELIANCE ON THE PROSPECTUS

Section 46(1) speaks of an investor who subscribes for shares or debentures 'on the faith of a prospectus' and who sustains 'loss or damage' by reason of 'any untrue statement' or by reason of the 'wilful non-disclosure' of any matter of which the person responsible for issuing the prospectus had knowledge or which he knew to be material. The question arises whether it is necessary for a plaintiff claiming compensation under this section to show it was *the actual untrue statement or the non-disclosed matter on which he relied.* Is it sufficient for him to show that the prospectus induced him to invest even though he did not advert to those parts of it which were untrue or did not rely on the absence of matter which in fact existed but which was not disclosed?

To take an illustration, X Ltd. publishes a prospectus for an issue of shares to finance the establishment of a mine in Ruritania. The prospectus names several prominent business personalities and mining experts as directors. A reads the prospectus and, duly impressed by the stature of the directors, applies for shares. The prospectus contained a statement that a royalty of $100 *per* ton will be payable to the Ruritanian government on ore extracted and processed. However, it subsequently appears that the royalty is payable on each ton actually extracted and the company, faced with a heavy bill for royalties, goes into liquidation. A. admits that he did not pay any attention to the statement in the prospectus as to royalties payable. Can he succeed in an action under section 46?

It is trite law, of course, that reliance on the supposed truth of an untrue statement is an essential element in an action for deceit or a suit for rescission based on innocent information. In the words of Buller J. in *Pasley v. Freeman*:[6] 'Fraud without damage, or damage without fraud, gives no cause of action; but where these two concur, an action lies.'

Damage in this context means the acting by the plaintiff upon the representations—if he did not act on the representations he shows no damage.[7]

This element of reliance on the truth of the untrue statement has been emphasized in a number of English authorities dealing with section 38 of the Companies Act 1867, an ancestor of section 46 of the Uniform Companies Act. However, before looking at these authorities for assistance in interpreting section 46 it is important to look at the terms of section 38. The section provided that:

> Every prospectus . . . shall specify the dates and the names of the parties to any contract entered into by the company, or the promoters, directors, or trustees thereof, before the issue of such prospectus . . .,

[6] (1789) 3 T.R. 51, 56.

[7] *Smith v. Chadwick* (1884) 9 App. Cas. 187, 195-96 *per* Lord Blackburn.

whether subject to adoption by the directors of the company, or otherwise; and any prospectus . . . not specifying the same shall be deemed fraudulent on the part of the promoters, directors and officers of the company knowingly issuing the same, as regards any person taking any shares in the company on the faith of such prospectus, unless he shall have had notice of such contract.

It is to be noted that the legislature equated failure to disclose material documents with fraud at common law. Why this was done is not clear. There seems to be no reason why a right of compensation could not be given to an investor who suffered from the non-disclosure of a material contract without applying the perjorative epithet of fraud to conduct which might well be completely honest. This blurring of the moral and subjective basis on which the Common law (coinciding in this respect with the attitude of the ordinary man) had placed the concept of fraud was repeatedly resisted by the Judges.

For example in *Cackett v. Keswick*[8] Vaughan Williams L.J. said:

I always approach these cases under the 38th section with a strong feeling of repugnance to the duty which I have to perform, because I think that the 38th section, which in effect provides that a man who omits to mention in a prospectus a contract which it would be material to an intending investor to know—I am taking Thesiger L.J.'s limitation of the section—shall although acting honestly be deemed fraudulent, is a section which no judge can give effect to, not only without a feeling of repugnance, but without a feeling that that which he is doing does not really tend to the maintenance of commercial honesty and commercial morality. To herd together, under a collective word like "fraudulent", people who are honest and people who are dishonest, to my mind, cannot possibly tend to the maintenance of commercial morality.[9]

In *Shepheard v. Broome*[10] that great commercial judge, Lord Lindley, put the matter with his characteristic succinctness: 'To be compelled by Act of Parliament to treat an honest man as if he were fraudulent is at all times painful.'[11]

But this introduction into the statute of a concept of notional fraud had another effect: it resulted in an insistence (influenced no doubt by the courts' deep-rooted distaste for the provision) on a plaintiff establishing all the elements of fraud at common law apart, of course, from the defendant's intent to defraud which was replaced by the statute-created element of failure to comply with the statutory requirements of the prospectus. This approach appears clearly from the judgment of Lord Lindley in *Macleay v. Tait*:[12]

On proof of the non-disclosure of a contract required to be disclosed, the section declares that the prospectus is to be deemed fraudulent on the part of the persons named in the Section. No evidence, therefore, of evil intention on their part is required to be given by the plaintiff, and

[8] [1902] 2 Ch. 456. [9] [1902] 2 Ch. 456, 471. [10] [1904] A.C. 342.
[11] [1904] A.C. 342, 346. [12] [1906] A.C. 24, 29.

> on the other hand the section renders proof by them that they had no evil intention immaterial. But an action for damages based on fraud, or on what is to be deemed fraudulent, can only be maintained by a person who can prove that the fraud, or what is to be deemed fraud, of which he complains, has caused him damage, and the question arises, how is this principle to be worked out when applied to actions based on section 38? . . . It is noteworthy that what is deemed to be fraudulent is the prospectus, and not merely the non-disclosure of a contract required to be referred to. The language of the section is consistent with the view that anyone who is induced to take shares by a prospectus which, although honest and true in all its statements, is to be deemed fraudulent, and who has lost his money by so doing, can maintain an action for damages, even although he was not in fact misled in any way whatever. He may have relied only on statements which were true, and the non-disclosed documents may be such that he would have attached no importance to them if he had known of them. The language of the statute is open to such a construction; but if so construed it leads to a result which is so unjust and so inconsistent with the principles which govern actions for damages occasioned by fraud, that some other interpretation consistent with the language of the section and with established principles ought to be sought for, and, if found, ought to be adopted.[13]

Accordingly *Macleay v. Tait*[14] finally established that in an action under section 38 the plaintiff must prove that he took his shares on the faith of there being no such contract as that omitted to be disclosed, and that if such contract had been disclosed to him he would not have taken his shares. In so doing the House of Lords approved what was said by Thesiger L.J. in *Sullivan v. Mitcalfle*;[15] (as against the view of Lord Bramwell L.J. in that case) and followed the decision of the Court of Appeal in *Nash v. Calthorpe*.[16] The suggestion had been made in earlier cases that the falsity of a material statement of fact coupled with damage amounted to a presumption of law in favour of the plaintiff.[17] However, in *Macleay v. Tait*[18] Lord Lindley put the matter simply on the basis of a *prima facie* inference of fact and held that if a plaintiff is challenged on the point he must go a step further and prove that he was misled by what makes the prospectus fraudulent,[19] *i.e.* the omission to disclose some document which ought to have been disclosed.

In passing it might be noted that the inherent difficulty of finding as a fact that an investor relied on the absence of a contract which, *ex hypotheses,* he knew nothing about, was the subject of some comment. A more realistic approach would perhaps have been to adopt the objective approach of contract rather than tort. In other words, the test would be: Would a reasonable man, knowing of the existence of the omitted contract, have taken up the shares?

[13] *Loc. cit.* [14] *Ibid.* [15] (1880) 5 C.P.D. 455.
[16] [1905] 2 Ch. 237.
[17] *McConnel v. Wright* [1903] 1 Ch. 546. 559 *per* Cozens-Hardy L.J.
[18] [1906] A.C. 24. [19] [1904] A.C. 24, 31.

In *Cackett v. Keswick*[20] Farwell J., after pointing out that the same principle must apply to the omission of a material fact as apply to the insertion of an untruth in a prospectus, pointed out that: 'It is easy to be wise after the event, and many men can honestly persuade themselves when a company has failed that they would have been influenced by a circumstance which in all probability would have made no impression whatever on their mind when considering an investment or speculation.'[21]

However, the writer feels that an Australian court might well take a different view on an action under section 46 of the Uniform Act. First, purely as a matter of grammar the reliance is referrable to the prospectus and not to the untrue statement or wilful non-disclosure. The section speaks of a person subscribing for shares or debentures 'on the face of a prospectus' and it is the loss or damage which must relate to the untrue statement, not the reliance. Secondly, the issue is not confused by the imputation of 'deemed fraud' with its common law connotations. Finally, it is not the only provision in the Act by which full personal liability of company officers is used as a sanction to enforce compliance with the Acts' requirements.[22]

The question still remains whether or not a plaintiff must show a *nexus* between the untrue statement or the wilfully non-disclosed matter and the damage suffered by him—*i.e.* the decrease in value of his shares or debentures. Under section 38 of the 1867 Act with its artificial concept of 'deemed fraud' there was some authority that this was not required. In *Twycross v. Grant*[23] for example, Cockburn CJ. said:

> The fraudulent character which the statute attaches to the omission to refer to such contracts in the prospectus does not in any degree depend on the result. If a contract is within the section, the omission to refer to it is made fraudulent whatever the result. The fact whether the result was brought about by it is, therefore, altogether beside the question.[24]

However, the words in section 46(1) 'loss or damage sustained by reason of any untrue statement therein, or by reason of the wilful non-disclosure therein of any matter of which he had knowledge and of which [the defendant knew] to be material', would seem to be too clear to permit of such an interpretation. The plaintiff would, therefore have to show that the failure of the company was connected with the subject of the untrue statement or wilful non-disclosure.

20 [1902] 2 Ch. 456.
21 [1902] 2 Ch. 456, 463.
22 E.g. s. 36 (prohibition of carrying on business with fewer than the statutory number of members) and s. 304 (responsibility for fraudulent trading when company is in course of being wound up).
23 [1877] 2 C.P.D. 469.
24 [1877] 2 C.P.D. 469, 531.

2. UNTRUTHFULNESS

In many cases there would be no doubt as to the untruthfulness of a statement appearing in a prospectus, but equally the courts have always refused to be fobbed off by the transparent device of a number of statements which, although literally true if taken in isolation, when read together create a false impression. As Lord Halsbury put it in *Aaron's Reefs Ltd. v. Twiss*:[25] 'If by a number of statements you intentionally give a false impression and induce a person to act upon it, it is not the less false although if one takes each statement by itself there may be a difficulty in showing that any specific statement is untrue.'[26]

Kylsant's Case[27] is a good example. There the prospectus was issued stating that the company had, for each year between 1911 and 1927, paid dividends varying from 5 to 8 *per cent*, except in 1914 when no dividend was paid and in 1926 when a dividend of 4 *per cent* was paid. This was quite true, but what the prospectus did not state was that between 1921 and 1927 the company had made substantial losses and had only been able to maintain dividends by using various reserves and wartime profits of a non-recurring nature. The clear impression created and intended to be created by the list of dividends paid was that the company was a flourishing concern—this, however, was contrary to the truth and consequently the prospectus was false.

The same approach would surely apply to section 46(1) even though the section speaks of 'any untrue statement'. It would be flying in the face of the true spirit of the above authorities if a plaintiff were required to isolate a further statement which could be shown as untrue.

3. DEFENCES OPEN TO DIRECTORS IN AN ACTION UNDER SECTION 46[28]

Little need be said about section 46(3)(a) as it would be a simple issue of fact whether or not the director withdrew his consent before issue, the onus of proof clearly being upon him. The withdrawal of

[25] [1896] A.C. 273.

[26] *Ibid.* p. 281. See also *Greenwood v. Leather Shod Wheel Co.* [1900] 1 Ch. 421, 440 *per* Romer C.J. and *Rex. v. Lord Kylsant* [1932] 1 K.B. 442.

[27] [1932] 1 K.B. 442.

[28] s. 46 (3) provides:

(3) No person [is liable under subsection (1) of this section] if he proves—

(a) that, having consented to become a director of the corporation, he withdrew his consent before the issue of the prospectus, and that it was issued without his authority or consent;

(b) that the prospectus was issued without his knowledge or consent and he gave reasonable public notice thereof forthwith after he became aware of its issue;

(c) that after the issue of the prospectus and before allotment or sale thereunder he, on becoming aware of any untrue statement therein, withdrew his consent and gave reasonable public notice of the withdrawal and of the reason therefor; or

(d) that—

(i) as regards every untrue statement not purporting to be made on the authority of an expert or of a public official document or statement, he had reason-

consent would no doubt have to be clearly and unequivocally communicated to the company.

However, a comparison of section 46(3)(a) with section 46(3)(b) appears to indicate a rather anamolous situation. If a director, who has at one stage consented to become a director of the corporation, withdraws his consent even as late as the day before issue of the prospectus there is no obligation on him to give any public notice of the withdrawal of his consent. And this is so presumably even if the prospectus is circulated describing him as a director and perhaps attracting investors by his reputation. On the other hand, a person who has never consented to the issue of the prospectus at all has a positive obligation cast upon him by section 46(3)(b) to give reasonable public notice.

What is 'reasonable public notice' would depend on the circulation of the prospectus and would, it is expected, involve at least newspaper advertisements.

Of more importance, however, are the three defences created by section 46(3)(d). These enable a director to rely on:

(i) reasonable belief in the truth of what is in fact an untrue statement;

(ii) reasonable belief that an expert was competent to make a report or valuation (provided that the statement of the expert in the prospectus was either a correct and fair copy of, or extract from, the report or valuation or fairly represented the statement made by the expert—this appears to be a strict test with the result that belief, albeit reasonable, in the textual accuracy of the expert's statement as it appears in the prospectus is not enough).

(iii) Correct and fair representation of an official statement or document which in fact contains an untrue statement. Again, the representation must be in fact correct; fair and reasonable belief in its correctness and fairness will not suffice.

It is clear from the authorities that the courts have imposed a high

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able ground to believe, and did up to the time of the allotment or sale of the shares or debentures believe, that the statement was true;

(ii) as regards every untrue statement purporting to be a statement made by an expert or to be based on a statement made by an expert or contained in what purports to be a copy of or extract from a report or valuation of an expert, it fairly represented the statement, or was a correct and fair copy of or extract from the report or valuation, and he had reasonable ground to believe and did up to the time of the issue of the prospectus believe that the person making the statement was competent to make it and that that person had given the consent required by section forty five to the issue of the prospectus and had not withdrawn that consent before delivery of a copy of the prospectus for registration, or, to the defendant's knowledge, before any allotment or sale thereunder; and

(iii) as regards every untrue statement purporting to be a statement made by an official person or contained in what purports to be a copy of or extract from a public official document, it was a correct and fair representation of the statement or copy of or extract from the document.

and objective standard of 'reasonable belief' and the mere fact that a director is misled—in the same way as investors—by other directors or officers of the company will not be enoough. Accordingly, it is well established that a director cannot rely on the uncorroborated statements of a vendor to a promoter of the company or of a fellow director: *Adams v. Thrift*;[29] *Bundle v. Davies*;.[30] This might be thought to impose an unrealistic obligation, particularly on an 'outside' director, who will in practice rely on the executive directors and other officers of the company for the collation of the material which ultimately appears in the prospectus. Is he obliged to make detailed inquiries himself into the financial records of the company to verify claims of previous profitability? Must he examine in minute detail the projected operation of some enterprise for which the company is seeking capital? If he is not professionally qualified, should he retain his own accountant or solicitor?

In *Adams v. Thrift*[31] Eve J. provides an answer to these questions:

> Counsel for one of the defendants contended that the arguments advanced on behalf of the plaintiff involved the consequence, that no director could discharge the onus of proving that he had reasonable ground for believing a statement to be true without showing that he had separate advice from his own lawyer, his own accountant, and, may be, from his own patent agent. I do not agree. In my opinion, the existence of reasonable ground for belief in the truth of any statement is established by the proof of any facts or circumstances which would induce the belief in the mind of a reasonable man, that is to say, a man who stands midway between the careless and easy-going man on the one hand and the over-cautious and straw-splitting man on the other. Who will deny that such a man might reasonably believe in the truth of statements verified by competent and independent agents, *instructed not by him individually, but by or on behalf of a board of directors of whom he was one?*[32] Had the board here collectively made or set about making an investigation such as I have indicated, and had that investigation led to a report that the statements were provided on fact and were substantially true, there is little doubt but that each member of the board might and would have been held to have had reasonable ground for entertaining the belief that the statements were true.[33]

Therefore, it appears that in the absence of special circumstances which might place him on enquiry (such as a basic error in acounting principle which would be apparent to a director who is not an accountant) a director is entitled to rely on the company's professional advisers. Indeed, if the position were otherwise it would be inconsistent with the defence expressly provided by section 46(3)(d)(ii) in relation to an expert's statement appearing in a prospectus.

[29] [1915] 1 Ch. 557.
[30] [1932] N.Z.L.R. 1097.
[31] [1915] 1 Ch. 557.
[32] The writer's italics.
[33] [1915] 1 Ch. 557, 565.

If a director is entitled to rely on the statement of an expert whose competence he has no reason to doubt, why should he not also be able to rely on the advice of company's solicitors or accountants which, although it may not appear explicitly in the prospectus, is something on which the board has placed just as much reliance?

But there is clear authority in the situation where material contracts are not disclosed in the prospectus that a mistaken belief that the contracts are not material and therefore need not be disclosed, even though based on professional advice, will not be a defence.[34] The explanation may be that we are to read section 46(3)(d)(i) as being restricted to a statement of fact and that the familiar, although perhaps logically specious, distinction between a mistake of law and a mistake of fact must be imported into this branch of the law. To take two illustrations.

A., a director of X Ltd., asks the company's solicitor whether Blackacre, over which the Company has an option, will be a suitable site for a factory. The solicitor affirms this and a statement to that effect appears in the prospectus. It subsequently appears that zoning restrictions will prevent the land being used for factory purposes.

In the second case, Blackacre is owned by the trustees of a deceased person's estate. B., a director of the company, has an interest in remainder in this estate and asks the company's solicitor whether this matter should be included in the prospectus. The solicitor advises that this need not be mentioned and the prospectus while referring to other interests as required by Item 17 of the Fifth Schedule, contains no reference to B's interest.

It is suggested that the director would be liable in the second case, but not in the first.

A director cannot protest that he was not a man of business and was misled by others whom he reasonably expected to be reliable. This point was well made in a joint judgment of the High Court which, although dealing with the case of trustees, is nevertheless very apposite:

> One cannot help feeling a degree of sympathy for the members of the board other than Rule—firstly because they had no qualifications for the task of investing trust funds, and secondly, because, in consequence, they relied very largely on Rule's judgment. But the standard to be applied is the standard of the reasonably prudent man of business, and it is nothing to the point that they were not men of business at all.[35]

If a director claims that he had a reasonable belief in the truth of a statement, he must deliver particulars of the grounds of his belief.[36]

[34] *Twycross v. Grant* (1877) 2 C.P.D. 469, 489, 543; *Watts v. Bucknall* [1903] 1 Ch. 766, 773; *Shepheard v. Broome* [1904] A.C. 342, 347.

[35] *Fouche v. Superannuation Fund Board* (1952) 88 C.L.R. 609, 641 *per* Dixon, McTiernan and Fullager JJ.

[36] *Alman v. Oppert* [1901] 2 K.B. 576.

It is not enough to show that each phrase in the prospectus was carefully examined and was true in isolation if the prospectus on the whole was misleading.[37]

THE PROSPECTUS REQUIREMENTS OF THE ACT

Section 37 is the key to the prospectus requirements of the Act. It provides that a person shall not issue, circulate or distribute any form of application for shares in, or debentures of, a corporation unless the form is issued, circulated or distributed together with a prospectus, a copy of which has been registered with the Registrar. Since any subscription for shares in, or debentures of, a corporation must entail the completion of an application form, section 37(1) makes it impossible to solicit subscriptions for shares or debentures without the registration of a prospectus.

One doubt which arises is whether or not section 37 (1) applies if the form of application is not issued, circulated or distributed to the public. Thus although section 37 (2) provides that sub-section (i) shall not apply if the form of application is issued, circulated or distributed in connection with shares or debentures which are not offered to the public, the situation may be envisaged where a form of application is issued non-publicly in respect of shares which are also offered to the public. This might well be relevant, for example, where an invitation is made to deposit money with a company and an application form distributed, for by virtue of section 5 (5) such an invitation is made to the public, is deemed to be an invitation to subscribe for or purchase debentures. Must a prospectus always accompany an application form in these circumstances?

Mr Justice Wallace and Mr J. McI. Young, Q.C.[38] put forward the view that the issuing, circulating or distributing referred to in section 37(1) must be to, or among, the public.[39] They argue that the reference in section 37(2) to 'shares or debentures which are not offered to the public' necessitates reference to section 5(6). Since issuing, circulating or distributing forms of application for shares is a means of offering such shares, then any issue *etc.* of a form of application which is not to the public will bring the operation of section 37(2) into play and prevent sub-section (1) from applying. This seems to be the correct view. The question of what is an offer to the public also arises of course for the purposes of section 37(2).

It may be of some value therefore to reappraise the authorities on the question of what is an offer to the public, particularly in the light of the High Court's recent decision in *Lee v. Evans.*[40] Earlier

37 *Greenwood v. Leather Shod Wheel Co.* [1900] 1 Ch. 421.
38 Wallace & Young, *Australian Company Law & Practice* (1965).
39 *Ibid.* 139.
40 (1964) 112 C.L.R. 276.

legislation[41] spoke of issuing prospectuses and, by definition, a prospectus offered shares to the public. Earlier cases are therefore still of value in determining whether there has been an issuing, circulating or distributing for the purposes of section 37(1).

Section 5(6) provides that a reference in the Act to offering shares or debentures to the public shall, subject to a contrary intention appearing, including a reference to offering them to any section of the public, whether selected as clients of the person issuing the prospectus or in any other manner. Four specific exceptions are then mentioned:

(a) an offer or invitation to enter into an underwriting agreement;
(b) an offer to a person whose ordinary business it is to buy and sell shares;
(c) an offer to existing members or debenture holders of a corporation relating to shares in or debentures of a corporation;
(d) an offer made in the course of a liquidation sale under section 270.

If, as Wallace and Young[42] suggest, the issuing, circulating or distributing of application forms is a mode of offering shares,[43] then section 5(6) will be of some assistance. However, it is to be noted that it does not purport to be an exhaustive definition, and it becomes necessary to look at the earlier authorities.

In *Sherwell v. Combined Incandescent Mantles Syndicate Limited*,[44] a prospectus marked 'strictly private and confidential; not for publication' was sent by some of the directors of the company to their friends, but without the authority of the company. It was held that there had not been an offer of shares to the public. The case went off mainly on the point that an 'offer of shares' meant an offer by the company and not by a person without the authority of the company.[45] But Warrington J. also pointed out that an 'offer to the public' meant 'an offer of shares to anyone who should choose to come in'.[46] This emphasis on the capacity to accept the offer is echoed in later cases.

A case in which the opposite view was taken was *In re South of England Natural Gas and Petroleum Co.*[47] There a prospectus headed 'for private circulation only' had been distributed by a promoter to shareholders in certain gas companies in which he was interested. Some 3,000 copies were sent out. It was held that this constituted an offer to the public.

41 Such as s. 81 (1) of the U.K. Companies (Consolidation) Act 1908 which was at issue in *Nash v. Lynde* [1928] 2 K.B. 93 (C.A.), (1929) A.C. 158 (H.L.).
42 Wallace & Young, *Op. cit.* 140.
43 *Ibid.* 139.
44 (1907) 23 T.L.R. 482.
45 This is to be contrasted with s. 37 (1) which prohibits an issue *etc.*, by 'a person'.
46 (1907) 23 T.L.R. 482, 483.
47 [1911] 1 Ch. 573.

The leading case on the topic is *Nash v. Lynde*,[48] a decision of the House of Lords. There, two documents were prepared by the directors of a company containing information about it. These documents were marked 'strictly private and confidential' and copies were sent to a solicitor with a request that he should find clients who might be prepared to invest in the company. The solicitor sent the documents to the plaintiff's brother-in-law who in turn sent them to the plaintiff.[49] It was held that the documents were not issued as a prospectus within the meaning of section 81(1) of the U.K. Companies (Consolidation) Act 1908.

Finally there is the case already referred to: *Lee v. Evans*.[50] Mr Lee had been prosecuted under the South Australian Registration of Business Names Act (1928-1961) with using or making reference to a business name in an invitation to the public to deposit money with, or lend money to, that firm, individual or corporation. In the course of obtaining money on loan for the purposes of a business being carried on by him under the registered business name 'Chawilla Timber Supply Co.', Mr Lee made reference to that business name to two gentlemen named Broadbent from whom he obtained loans for the purposes of the business. A majority of the High Court (Windeyer J. dissenting) held that proof of an invitation to an individual or individuals as a member or members of the public is not of itself proof of an 'invitation to the public' within the meaning of the Act.

We may deduce from the above cases that some of the factors taken into account by the courts can be classified as follows:

(a) *Extent of distribution*

The greater the number of people receiving the offer, the more likely is it to be an 'offer to the public'. Thus in *In re South of England Natural Gas and Petroleum Co.*[51] the fact that almost 3,000 copies of the prospectus had been distributed was treated as a compelling reason for characterising it as an offer to the public. In his dissenting judgment in the Court of Appeal in *Lynde v. Nash*,[52] Scrutton L.J. emphasized this by contrasting the *South of England Gas Case*[53] and *Sherwell's Case*;[54] and concluded: 'It seems to me to be a question of degree whether there is a sufficiently general offering to make it a public offer, or such a limited selected distribution as to make it private negotiation.'[55]

48 [1929] A.C. 158, *sub nom Lynde v. Nash* [1928] 2 K.B. 93 (C.A.).

49 The Case has a number of curious features. The plaintiff was concerned not so much with subscribing for the company's shares as with finding employment. Also he never applied for any of the shares offered in the prospectus but took up part of the original shares which remained unissued. [1929] A.C. 158, 167 *per* Viscount Sumner. However these points do not appear to have been decisive.

50 (1964) 112 C.L.R. 276.

51 [1911] 1 Ch. 573.

52 See n. 48.

53 [1911] 1 Ch. 573.

54 (1907) 23 T.L.R. 482.

55 [1928] 2 K.B. 93, 102.

But the number of recipients cannot be a conclusive test, as Viscount Sumner recognized in *Nash v. Lynde*:[56]

> '"The public" . . . is of course a general word. No particular numbers are prescribed. Anything from two to infinity may serve: perhaps even one, if he is intended to be the first of a series of subscribers, but makes further precedings needless by himself subscribing the whole.'

Frankly, the writer finds difficulty in reconciling this view with the decision of the majority in *Lee v. Evans*.[57] There, although the invitation to the Broadbents was made, in the words of the South Australian Full Court, as an 'incident in the course of a campaign to raise money from the public'[58] the Court restricted its attention to an analysis of the Broadbent transaction with the result that it found itself unable to find the necessary public element.[59]

(b) *Exclusiveness of distribution*

Quite apart from the numerical extent of distribution, the class of persons to whom distribution is made will be relevant. For example, while distribution among members of a family would not involve a public element, a distribution to an identical number of persons who happened to walk past a street corner at a given time might be a public distribution. The express exception made by section 5(6)(c) of the Act to the case of an offer made to existing members or debenture holders of a company relating to shares in or debentures of the company,[60] is one of long standing in companies legislation. This is of course of great practical importance: it means that new share or debenture capital can be raised from the existing members or debenture holders of the company without the inconvenience and expense of preparing a prospectus. In *Nash v. Lynde*[61] Lord Buckmaster used a similar provision as an argument to emphasize that a distribution among a well defined class of the public would still be an offer to the public; such an exempting provision would not be necessary, he said, if an issue to such a limited class were not *prima facie* included within the category of offers to the public.[62]

This points up the very different approach adopted in the law of charities where, for example a gift, otherwise charitable, will fail as not having a sufficiently public character if it is made for the benefit of children of employees or former employees of a very large company.[63]

56 [1929] A.C. 158, 169.
57 (1964) 112 C.L.R. 276.
58 [1964] S.A.S.R. 210, 216.
59 E.g. (1964) 112 C.L.R. 276, 287 *per* Kitto J. See however the explanation of *Nash v. Lynde* by Barwick C.J. (1964) 112 C.L.R. 276, 286.
60 E.g. *Burrows v. Matabele Gold Reefs & Estates Co. Ltd.* [1901] 2 Ch. 23, 27 *per* Farwell J.
61 [1929] A.C. 158. 62 *Ibid.* 171.
63 *Oppenheim v. Tobacco Securities Trust Co.* [1951] A.C. 297.

Accordingly, an offer will not escape the character of an offer to the public by being made to members of the public united by some particular private characteristic such as membership of a club or other voluntary association, or residence in a particular locality. Although each case must of course be dealt with on its own facts, the basic concept remains of an invitation which '. . . though maybe not universal, is general; that it is an invitation to all and sundry of some segment of the community at large'.[64]

(c) *Capability of acceptance*

The offer must also be looked at not only from the point of view of its distribution (both in quantitative and categorical terms) but also in the light of who may accept it. *Lee v. Evans*[65] appears to have finally established this as the crucial test. As was said in *Ex parte Lovell, re Buckley*,[66] the expression 'offer to the public' envisages one of the *Carlill v. Carbolic Smoke Ball Co.*[67] type: one which is made to the public generally and therefore capable of being acted upon by any member of the public. Barwick C.J. predicated an offer to the community or a segment of the community (how large a segment must depend on the circumstances) but *within that segment* the invitation must be general in the sense that it is an offer to anyone who should choose to come in.[68] In other words, if the offer is made to the customers of X Ltd. or the members of the Y Club or the residents of Z street, then provided in each case the segment of the community is sufficiently large in the circumstances to be regarded as a 'sufficient area of the community' then an offer which on its face is capable of acceptance by any member of that group will be an offer to the public.[69] Thus *Lee v. Evans* itself turned on the fact that the invitation was addressed to the Broadbents and could only be accepted by them.[70]

Barwick C.J. did recognize that an invitation which is not *ex facie* an invitation to the public can be found to be such an invitation because of the nature of the authorized distribution it was given.[71] The practical danger of being able to 'dress up' what is in essence an offer to an individual as an offer to the public is obvious.[72] Nevertheless it is felt that after *Lee v. Evans*[73] this danger still remains a real

64 Barwick C.J. in *Lee v. Evans* (1964) 112 C.L.R. 276, 285.
65 *Loc. cit.*
66 (1938) 38 S.R. (N.S.W.) 153, 159.
67 [1893] 1 Q.B. 256.
68 (1964) 112 C.L.R. 276, 285-286.
69 (1964) 112 C.L.R. 276, 286 *per* Barwick C.J.
70 (1964) 112 C.L.R. 276, 286 *per* Barwick C.J. p. 287 *per* Kitto J. p. 290 *per* Taylor J. See also *Government etc. Stock Co. v. Christopher* [1956] All E.R. 490.
71 (1964) 112 C.L.R. 276, 285.
72 *Lynde v. Nash* [1928] 2 K.B. 93, 107 *per* Atkin L.J.
73 (1964) 112 C.L.R. 276.

one, particularly if the enterprizing share pusher plans his *modus operandi* in the light of Kitto J.'s distinction between '. . . the case of an invitation which itself is open to acceptance by any member of the public who may be interested and the case of an invitation which itself is open to acceptance by a specific individual only but, if declined by him, is likely to be followed by similar invitations to other specific individuals in succession until an acceptor is found. The first of these is a case of an invitation to the public; the second, in my opinion, is not.'[74]

CIVIL REMEDY FOR BREACH OF STATUTORY REQUIREMENTS

A penalty of $2,000 is prescribed for a breach of section 37(1). However, the remedy of a person who subscribes to shares or debentures in circumstances constituting a breach of the section is not clear. Is such a person entitled to damages or to rescission of the contract for the securities?

Wallace and Young[75] suggest that if damage can be proved, an action for breach of statutory duty may be maintained.

However, *In re Wimbledon Olympia Ltd;*[76] *In re South of England Natural Gas Co.*[77] and *Commonwealth Homes & Investment Co. Ltd. v. Smith*;[78] provide some authority that rescission will not be available merely for breach of the statutory requirements. Also in light of section 46 it might be felt that the legislature had by implication laid down exclusively the circumstances under which civil remedies could be obtained in addition to common law and equitable rights of action.

A similar problem arises in relation to section 39(5) which provides a penalty (again $2,000) for every person who is responsible for issuing a prospectus that does not comply with the requirements of the Act. Again, Wallace and Young take the view that a remedy in damages can be maintained against a person responsible for a breach of the provision.[79] In support of this proposition they cite the following authorities: *In re Wimbledon Olympia Ltd.*;[80] *In re South of England Natural Gas Co.*[81] and *Commonwealth Homes & Investment Co. v. Smith*[82]; and reference is also made to *Nash v. Calthorpe*[83] and *Macleay v. Tait.*[84]

With respect to the learned authors, it would appear that none of these authorities sufficiently supports the proposition that non-com-

74 *Ibid.* 287.
75 *Op. cit.* p. 139.
76 [1910] 1 Ch. 630.
77 [1911] 1 Ch. 573.
78 (1937) 59 C.L.R. 443.
79 *Op. cit.* p. 156.
80 [1910] 1 Ch. 630.
81 [1911] 1 Ch. 573.
82 (1937) 59 C.L.R. 443.
83 [1905] 2 Ch. 237.
84 [1906] A.C. 24.

pliance with the prospectus requirements will ground an action where neither a common law remedy nor an action under section 46 is available.

In re Wimbledon Olympia Ltd[85] was decided on the ground that there was misrepresentation in respect of actual statements in the prospectus. Neville J. dealt (*obiter*) with an alternative ground for the plaintiff's claim, *viz.* that the omission of matter required by the Companies (Consolidation) Act 1908 to be stated,[86] alone entitle him to have the register rectified. This argument was rejected but nothing was said about a claim for damages in these circumstances. The most that can be culled from the judgment is the comment: 'Of course there may be omissions of such a character that they would on other grounds entitle the shareholders to this relief, but in this case we have only the bare fact of omission.'[87] This falls far short of saying that a failure to comply with statutory requirements *per se* grounds an action in damages.

In re South of England Natural Gas and Petroleum Co.[88]; was also a claim for rectification of the register and therefore the question of a right to damages was unnecessary for the decision. Admittedly Swinfen Eady J. did say: 'But the section does contemplate a liability in damages on the part of the "directors and other persons responsible for the prospectus" for subsection (6) exonerates such persons from liability if they can prove certain matters.'[89] However, the section in question (section 81 of the Companies (Consolidation) Act 1908) did not contain any penalty creating provision comparable to section 39 (5) of the Uniform Companies Act. The section obviously did 'contemplate a liabilty' because it contained exemption provisions and as no offence was created it was reasonable to infer that the liability from which exemption was provided in certain circumstances was a civil one sounding in damages. As Crisp J. pointed out in *Roberts v. Roberts*,[90] if the legislature fails to supply an adequate penalty for breach of a statutory provision there is a strong inference that it was intended to confer rights on individuals suffering damage by virtue of a breach of the statute. Surely the converse argument applies if there is a penalty (and a substantial one) specifically provided.

Commonwealth Homes & Investment Co. Ltd. v. Smith[91] was again a claim for rectification only. Dixon J. stated, *obiter*, that failure to comply with prospectus requirements did not give a right to rescission but only a right to damages against the directors.[92] He

85 [1910] 1 Ch. 630.
86 *Ibid.* 631.
87 *Ibid.* 632.
88 [1911] 1 Ch. 573.
89 *Ibid.* 576-577.
90 [1957] Tas. S.R. 84, 107.
91 (1937) 59 C.L.R. 443.
92 *Ibid.* 460.

cited as well as the *Wimbledon Olympia Case*;[93] and the *South of England Natural Gas Case*;[94] the early authority of *Re Coal Economising Gas Co. (Gover's Case)*.[95] On examination, however, this latter case, which also only dealt with a claim for rectification, was decided by the majority on the ground that a certain contract, not disclosed in the prospectus, was not required to be disclosed in the prospectus either by common law or statute. The plaintiff's claim therefore failed *in limine*. But in dealing with the possibility of a claim against the directors under the Act[96] for damages, the court's attention was confined to the provision (already referred to in this article) that in the event of the omission of any material contract from a prospectus it should be 'deemed fraudulent'. Such a provision, of course, is clearly the forerunner of section 46 of the Uniform Act and is no authority for a statutory right of damages outside that section. *Nash v. Calthorpe*[97] and *Macleay v. Tait*[98] also deal with the 'deemed fraudulent' provision.

To summarize, it would appear therefore that there is no right of action for damages in respect of a breach of the prospectus provisions of the Uniform Companies Act outside the right specifically created by section 46. This conclusion is strengthened by the general reluctance of the courts to allow actions by shareholders against directors in respect of their conduct of the affairs of the company.[99]

93 [1910] 1 Ch. 630.
94 [1911] 1 Ch. 573.
95 [1875] 1 Ch.D. 182.
96 30 & 31 Vict. c. 131, s. 38.
97 [1905] 2 Ch. 237.
98 [1906] A.C. 24.
99 Generally known as the Rule in *Foss v. Harbottle* (1843) 2 Hare 461; see Gower, *Modern Company Law* (2nd ed. 1959) ch. 25.